

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

June 18, 2002

The Capital Projects and Bond Oversight Committee met on Tuesday, June 18, 2002, at 1:00 PM, in Room 129 of the Capitol Annex. Representative Jodie Haydon, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Jodie Haydon, Chair; Senators Tom Buford, Bob Jackson, and Robert Leeper, Vice-Chairman; Representatives Robert Damron and Paul Marcotte.

LRC Staff: Pat Ingram, Nancy Osborne, and Shawn Bowen.

Guests testifying before the committee: Mike Baker, Northern Kentucky University; Secretary Kevin Flanery, Jim Abbott, Jamie Link, Don Mullis, and Tom Howard, Finance and Administration Cabinet; Cicely Lambert and Garlan Vanhook, Administrative Office of the Courts; Warren Nash, Economic Development Cabinet; Bill Hintze, Governor's Office for Policy and Management; Mike Herrington, Stites and Harbison; and Debby Milton, Kentucky Infrastructure Authority.

Senator Buford made a motion to approve the minutes of the May 21 meeting as submitted. The motion was seconded by Senator Leeper and passed by voice vote.

Chairman Haydon said Ms. Nancy Osborne would be filling in today in the absence of Ms. Mary Lynn Collins, the Committee Staff Administrator. He called on Ms. Osborne to review correspondence and information items included in members' folders. Ms. Osborne noted the first item was follow-up correspondence from Chairman Haydon to state officials requesting review of issues identified during last month's discussion of projects initiated by the University of Kentucky Wildcat Foundation. She stated there was also correspondence from Finance and Administration Cabinet Secretary Flanery regarding the committee's rejection last month of the proposed Kentucky Economic Development Finance Authority bond issue for Republic Services, Inc., and correspondence from Angela Martin, Vice President for Finance, Council on Postsecondary Education, reporting an amendment to the 2002-04 list of projects eligible for agency bond pool authority.

Ms. Osborne said also included in members' folders was the monthly Kentucky Lottery Corporation report; notices by Standard & Poor's and Moody's Investor Services

putting the state on their "watch lists" for a possible bond rating downgrade; and two news articles relating to the budget shortfall and possible use of the Budget Reserve Trust Fund.

Chairman Haydon said the first item of new business was a project report submitted by the University of Kentucky. The university plans to purchase scientific equipment for the Center for Applied Energy Research. Agency funds will be used to purchase the equipment at a cost of \$131,470. Chairman Haydon said purchases of unbudgeted equipment must be reported to the committee, but no further action is necessary.

Chairman Haydon then called on Mr. Mike Baker, Vice President for Administration and Finance, Northern Kentucky University (NKU), to discuss a land acquisition report. As part of the university's Master Plan, NKU has acquired 11 acres of land adjacent to the university campus. The cost of the acquisition was \$550,000 and the land was purchased as part of NKU's 2000-02 authorized Land Acquisition Pool. Chairman Haydon said this acquisition, costing over \$400,000, must be reported, but no further action is required.

Mr. Jim Abbott, Director for the Division of Real Properties, reported lease amortizations under \$50,000 for two state agency leases: PR-3443-Department of State Police (Jefferson County) and PR-3960-Department of Insurance (Franklin County). The costs of the improvements, \$14,025 and \$3,627 respectively, will be amortized over the remaining term of each agency's lease. Chairman Haydon said no action was required.

Next, Ms. Cicely Lambert, Director, Administrative Office of the Courts (AOC), and Mr. Garlan Vanhook, AOC General Manager for Facilities, reported AOC's Court Facilities Standards Committee has approved a \$27,210 increase in the Webster County Courthouse project's authorized annual use allowance. The Court Facility Use Allowance Contingency Fund is to be used to fund the cost overrun. The project, which includes a new two-story justice center and renovation of the existing third floor circuit courtroom, was initially authorized as part of a construction pool by the 1996 General Assembly. The project was revised by the 1998 General Assembly at a scope of \$2,265,000 with a maximum annual use allowance of \$181,400.

Senator Buford made a motion to approve the cost overrun for the Webster County Court Facility. The motion was seconded by Senator Jackson and passed by voice vote. The revised project scope is \$3,620,000 with a use allowance of \$208,610.

Chairman Haydon then asked Mr. Bill Hintze, Deputy State Budget Director, Governor's Office for Policy and Management, and Mr. Jamie Link, Deputy Commissioner, Department for Facilities Management, to discuss the project report submitted by the Finance and Administration Cabinet. Mr. Hintze first reported

emergency authorization for structural repair and mold abatement at the Madisonville Community College Gray Building. Mr. Hintze said the project was initiated at a cost of \$350,000 (agency funds), and at that time, did not require legislative approval. However, the Department has since determined it will cost approximately \$582,000 to remedy the problem. Mr. Hintze said this project was declared an emergency due to its character and timing. Funding for the project is from the 2000-02 Capital Renewal and Maintenance Pool.

Representative Damron asked if the Kentucky Community and Technical College System has had these types of problems before. Mr. Hintze said they have had this problem at other schools, but not at Madisonville.

Representative Damron asked if there was a reason why this problem exists at more than one school and if the buildings were designed by the same architect. Mr. Link said he would find out whether the buildings were designed by the same architect, but he was not aware of any contractor fault or responsibilities. He said the problem may be related to aging HVAC systems.

Representative Marcotte said according to articles he has read lately, mold in buildings is becoming a nationwide problem. Mr. Link said problems with roofs or water infiltration will cause mold problems, and a lot of the HVAC systems in these buildings have exceeded their useful life. Chairman Haydon said no action was required for this project.

Mr. Hintze next reported a \$219,000 privately funded scope increase for the Cynthiana extension of Maysville Community College. This project was initially authorized by the 1998 General Assembly for \$2,500,000 (bond funds), and received additional funding of \$200,000 (bond funds) by the 2000 General Assembly. In addition, the committee approved the use of \$431,000 in private funds for the project in December 1999. The purpose of the most recent increase is to purchase additional instructional equipment and building furnishings.

Senator Buford made a motion to approve the scope increase. The motion was seconded by Senator Leeper and passed by voice vote. The revised project scope is \$3,350,000.

Mr. Hintze next reported an emergency authorization for the Fort Boonesborough State Park. The project will entail reconstruction of buildings at the park that were damaged by fire in February 2002. Mr. Hintze said proceeds from the park's insurance will cover the cost of the repairs. Chairman Haydon said no action was necessary for this project.

Chairman Haydon then introduced Mr. Warren Nash, Deputy Commissioner, Economic Development Cabinet. Mr. Nash presented an Economic Development Bond (EDB) project to benefit Pella Corporation, a manufacturer of windows and doors, with a new plant in Calloway County. The Cabinet is proposing to make a grant of \$800,000 to Pella, through the Calloway County Fiscal Court. Proceeds will be used to cover a portion of the cost for purchasing a 733,000 SF manufacturing space vacated by Mattel, Inc. Pella will be required to create and maintain a workforce of 550 full-time employees at an average hourly wage of \$14.47. If they fail to meet the requirements of the grant, they will have to pay back a portion of the loan principal, based on jobs and salary requirements, to the Calloway County Fiscal Court.

Senator Jackson made a motion to approve the EDB grant for Pella. The motion was seconded by Senator Buford and passed by voice vote.

Mr. Nash next discussed an EDB grant in the amount of \$7,988,000 for the Hardin County Fiscal Court and for the Elizabethtown-Hardin County Industrial Foundation if the Fiscal Court determines the foundation to be the purchaser of this property. The funds will be used to purchase approximately 1,600 acres of contiguous land for use in attracting a major manufacturing facility to Hardin County. This land had been the proposed site of the Hyundai Plant.

Mr. Nash said the cost of the property will exceed \$17.7 million. The Economic Development Cabinet is considering making a Kentucky Economic Development Finance Authority (KEDFA) loan up to \$10 million to fund the remaining portion of the project. As a condition of the EDB grant, the land is only to be used for marketing to major industrial prospects. Mr. Nash said under the terms of the grant, the property shall not be used by the county or the foundation for any other form of development and, the Cabinet, KEDFA, and the legislature must approve the transfer of the property to any industrial prospect. Mr. Nash said if the foundation fails to use the proceeds in accordance with the agreement, they will have to repay the entire grant amount to Hardin County. If the foundation sells this land to a major industrial prospect, the proceeds must be paid directly to the Hardin County Fiscal Court, and any funds derived from the sale of the property must be used for economic development purposes and projects approved by KEDFA.

Senator Buford cited the high cost of the land, and made a motion that the committee reject this EDB proposal.

Representative Damron said he understood there were costs already incurred relating to core drillings and legal fees. He asked how much money was spent in Hardin County in preparing for the Hyundai Plant and for what services. Mr. Nash said he was not involved in the negotiations for the Hyundai Plant, and did not have that information. Representative Damron asked if any funds from the grant would be used to retire debt

associated with efforts to acquire the plant. Mr. Nash responded that to his knowledge, the money would not be used to retire previously incurred costs. He noted that the terms of the grant are very specific, and the legislature would be provided documentation as to how the funds are spent.

In response to another question from Representative Damron, Mr. Nash said the Holston Holding Corporation, part of CSX, has obtained the options on this property, and assumed the costs incurred so far related to development of this property. He said the proceeds from the grant are to be used solely for the purchase of the land and associated costs.

Representative Damron said the initial EDB proposal called for the funds to revert to the state, not the county, if the property was not acquired. Mr. Nash said this was correct, but the original proposal was to be cash funded. He said under the current proposal, the project is to be bond funded and in order to retain the tax-exempt status on the bonds, the money cannot be returned to the state.

Representative Damron asked why the state is trying to acquire this land when the General Assembly is not in session. Mr. Nash said they would like to have the bonds committed prior to the end of the fiscal year. Otherwise, the bond authorization will lapse.

Representative Damron asked if there is a potential client for this land or if the Cabinet is simply trying to spend the money before the end of the fiscal year. Mr. Nash said at this point, there is no client. He said the \$17.7 million is based upon the anticipated purchase price of the land, and that estimate does not include closing costs.

Representative Damron asked if this project is not funded, will some other area of the state be eligible for the funds. Mr. Nash said if the EDB funds are not committed before the end of the fiscal year, they will not be available to anyone.

Senator Leeper asked if the urgency for approving this project is that the bonds will expire July 1. Mr. Nash said that is a major reason, but they want to have the land purchased prior to negotiating with the next prospective client. Mr. Warren said the land is under option until October 2002.

Senator Buford said purchasing this land at this price would not be a good move for the state since it would tie up the state's bond capacity. He also questioned the purchase of vacant land with no prospects. He noted industrial parks in the state are having a difficult time attracting companies. He restated his motion to reject the proposal.

Finance and Administration Cabinet Secretary Kevin Flanery said having the land available would be beneficial for future negotiations, and it would assure state economic

officials do not get caught in a situation where they cannot deliver in the later stages of negotiation.

Senator Leeper said the state also has land optioned in Graves County in hopes of attracting a major industry, and he did not understand why the money is being spent in Hardin County and not in Western Kentucky. Secretary Flanery said the decision was based on location. The property in Hardin County has great access to highway, rail, and other modes of transportation.

Senator Buford asked if the Cabinet will be coming back to the committee seeking additional funds for infrastructure needs of the Hardin County property. Mr. Nash said they would have to make that decision based on what the project needs are, but it is their intention to keep the land together as one tract.

Senator Buford reiterated he did not understand why the state wants to buy this property when there is no potential client. He said there is plenty of time to negotiate purchase of the land. Secretary Flanery said this property is being pursued in order to attract a different type of client. They want to keep the property together so they can bring a major manufacturing facility to Kentucky. He noted the process of procuring multiple tracts can require more time than is sometimes available during major economic development recruitment. Mr. Nash added that by purchasing the land now, it takes a major issue off the table. As an example, he said when the state was trying to secure the Hyundai plant, the land acquisition process went for some time, and they were not able to secure the land in the time allotted.

Chairman Haydon said it would be difficult to find a tract of available land this large along any portion of I-65 or I-75. Senator Leeper said in Western Kentucky they are about to get 2,000 acres optioned that could be bought for much less than the price for the Hardin County land. He asked how he could go home and tell his constituents the state is spending more to acquire less acreage in Hardin County. Secretary Flanery said this acquisition has been discussed for some time, and they believe it can be a marketable asset for Kentucky.

Senator Jackson said if this project is approved and the remaining KEDFA funds for the fiscal year are used (as well as EDB funds), what will happen if a potential client comes to Kentucky and there are no recruitment incentive funds available. Mr. Nash said even if KEDFA funds are used to purchase property, there will be \$11 to \$15 million available in the KEDFA loan pool for low interest loans. However, he did indicate that all funds from the Economic Development Bond Pool will be committed.

In response to another question from Senator Jackson, Mr. Nash said he did not know the terms of the options the state has on the land. He introduced Mr. Mike Herrington of Stites and Harbison, who provides legal counsel to KEDFA. Mr.

Herrington said a major problem with having options on the land is that the landowners have a fairly substantial period of time to relocate. He said this was a difficult problem to overcome during the Hyundai negotiations. He said the 51 landowners involved are all willing sellers, except for one. He indicated, however, at this point, there is no plan to take the any of the landowner's property through condemnation.

Senator Jackson said he did not think it was necessary to have all the property acquired for this project, but they should have options to purchase. Mr. Herrington said when the state is in direct competition with other jurisdictions, the company sets their own timelines, and if another jurisdiction has a site already purchased, that can be very advantageous. Secretary Flanery said the type of industry they are trying to recruit in Hardin County is one that will produce spin-off businesses, and they must consider the overall impact to the Commonwealth.

Representative Damron moved to amend Senator Buford's motion to reject this project. The amended motion to delay consideration of the project until the committee's July meeting was seconded by Senator Buford and passed by voice vote.

Next, Secretary Flanery and Mr. Don Mullis, Executive Director, Office of Financial Management, discussed the state's bond ratings. Secretary Flanery said Standard & Poor's and Moody's Investor Services have put the state on their "watch lists" for a possible bond rating downgrade. He said that does not mean the state's credit rating has been downgraded, but it means the agencies will be looking at the state over the next several months to see how it deals with the absence of a legislatively-enacted budget and with budget shortfalls.

Representative Damron observed that being put on a watchlist can have a negative impact in the market place. Mr. Mullis agreed this was a factor they will have to face in their next marketing effort.

Representative Damron said it is not just the state's future bond rating that is affected, there are a lot of different entities such as the schools that would also be affected. He asked the Cabinet to develop a monitoring report to determine the effects of the action.

Representative Damron asked if the rating agencies' main concern was the state's utilization of the Budget Reserve Trust Fund (BRTF) and the inability of the General Assembly to pass a budget. He also asked what steps the Administration is taking to limit spending in the biennium so money can be placed in the BRTF.

Secretary Flanery said when the rating agencies take action, up or down, it impacts the state's reputation, which in turn has an impact on who comes to the table, and how a deal will be structured. He said the rating agencies are concerned by both the lack of a

budget and the use of the BRTF. He said it is too early to decide what they are going to do with regards to rebuilding the BRTF, but they are looking at different options, and will be talking to the committee about those options.

Representative Damron asked what happens if the state's bonds are downgraded. Mr. Mullis said there is a cost associated with having your credit questioned, and estimated it would probably be in the range of five to ten basis points.

Representative Damron asked if a lack of an enacted budget would impact the state's proposed Tax and Revenue Anticipation Note (TRAN) issuance. Mr. Mullis said the impact will be one of timing. TRANs are sold and extinguished within the fiscal year and do not ever become debt. He said the current uncertainty relating to a shortfall means they will be slower in getting revenue and expenditure estimates in order to size the issue and go to market. This reduces the opportunity to earn interest on TRAN proceeds before they are needed. He explained the best time to generate investment income from a TRAN is in the very first part of the year (July) while the state still has available funds. He said by issuing TRANs, the state does not have to borrow from other available funds currently invested. Issuance of TRANs is for cashflow purposes, and it is a less expensive way to continue to meet needs as revenues are collected.

Secretary Flanery said the state will be able to issue a TRAN, but they will not be able to put it in place until August 1, whereas they normally try to issue a TRAN by July 1 in order to earn interest on the TRAN proceeds before they are needed for cash flow purposes.

In response to a question from Representative Damron, Mr. Mullis said they conferred with legal counsel regarding the TRANs issuance.

Senator Buford asked how many states placed on a credit agency watchlist have had their bonds downgraded. Mr. Mullis said since January 2000, there have been 16 states that have had their credit outlook changed, and four states have had a rating change. Bonds in two of those states, California and Tennessee, have been downgraded.

Senator Buford asked if the state's bond rating would improve if the state did not do any bonding until the next session. Mr. Mullis said to address rating agency concerns, a budget needs to be enacted that is structurally balanced and that provides liquidity to withstand economic problems that might be encountered.

Senator Buford asked about the status of the BRTF. Secretary Flanery said as they close out the fiscal year, the BRTF will not exist. Mr. Mullis said the loss of the liquidity and the fact that there is virtually no other liquidity left in the system after fiscal year 2002 is closed, is a major concern.

Senator Buford asked if the Governor can do bonding without the General Assembly's approval. Secretary Flanery said they do not plan to issue bonds in fiscal year 2003 without a legislatively-enacted budget.

Mr. Mullis next discussed a new bond issue: Northern Kentucky University (NKU) Certificates of Participation (COP), Series 2002, for the NKU Student Housing Facilities project. Mr. Mullis said this project does not require approval by the Office of Financial Management, but they were asked to review the transaction. He said the COP takes a lease and "participates" the ownership of that lease out to willing buyers. He said NKU financed its previous housing development this way. The lease will house approximately 400 people in apartment-style housing. Mr. Mullis said they have looked at the basic documents underlying the transaction, and the projected revenues appear sufficient to carry the cost of this transaction over its lifetime, which is estimated to be approximately 25 years.

Senator Buford asked who would be responsible if NKU could not make required payments. Mr. Mullis said the lessor (Fifth Third) would be responsible. He added the transaction is insured which provides additional protection.

Representative Marcotte made a motion to approve the NKU Certificates of Participation. The motion was seconded by Senator Buford and passed by voice vote.

Mr. Tom Howard, Deputy Executive Director, Office of Financial Management, reported a new bond issue: Kentucky Asset/Liability Commission (ALCo) Project Notes, 2002 General Fund Series. The proceeds will be used to fund the Economic Development Bond Pool projects, including the Hardin County Industrial Park project, in the amount of \$12,293,000.

Representative Damron made a motion to approve the ALCo bond issue, excluding the amount proposed for the Hardin County Industrial Park project. The motion was seconded by Senator Buford and passed by voice vote.

In response to a question from Representative Damron, Mr. Hintze discussed the various options available to the Finance Secretary in light of the Committee's earlier decision to defer action on EDB funding of the Hardin County projects.

Mr. Howard reported another new bond issue: ALCo Project Notes, 2002 Agency Fund Series, \$65,660,000. The proceeds will be used to finance state agency fund and university agency fund supported projects.

Representative Damron made a motion to approve the new bond issue. The motion was seconded by Senator Buford and passed by voice vote.

Mr. Howard discussed a revised bond issue for Eastern Kentucky University (EKU) Housing System Revenue Bonds, Series O, dated June 1, 2002. He said since the last meeting, a change in the use of the fund proceeds has been made. The scope of the Combs Hall project is being reduced and additional money is being added to fund the construction of the Greek Row Project. Chairman Haydon said this bond issue was approved by the committee at its May meeting, and no further action is required.

Lastly, Mr. Howard reported three new bond issues with School Facilities Construction Commission (SFCC) debt service participation: Grant County, Marion County, and Russell County.

Representative Marcotte made a motion to approve the school bond issues with SFCC debt service participation. The motion was seconded by Senator Leeper, and passed by voice vote. Representative Damron abstained from the vote, citing a potential conflict of interest.

Chairman Haydon said there were four locally-funded school bond issues submitted to the committee for review this month: Jefferson County (2), Oldham County, and Taylor County. He said all disclosure information has been filed, and no further action on the bond issues are required.

Chairman Haydon next introduced Ms. Debby Milton, Kentucky Infrastructure Authority (KIA), to present four projects proposed for KIA assistance. He noted this was Ms. Milton's final appearance before the Committee due to her upcoming retirement, and he thanked her for her assistance to the Committee. The first project presented was a Fund A loan for the City of Wurtland for wastewater treatment plant improvements in the amount of \$1,782,900. In addition, three Fund F loans were presented: \$1,542,365 for the City of Hopkinsville for a raw water intake replacement project; \$557,000 for the City of Booneville for construction of a new water tank and renovation to the existing water treatment system; and \$3,646,238 for the City of Louisa for expansion and upgrade of the city's water treatment plant.

Senator Buford made a motion to approve the KIA loans. The motion was seconded by Senator Leeper and passed by voice vote.

Representative Damron asked why the engineering costs for the Hopkinsville project are so high (the ratio of engineering costs to construction costs is 24.73%). Ms. Milton said the project costs were thoroughly reviewed by the Division of Water, the KIA staff and the KIA Board.

Ms. Milton reported six projects funded from the 2020 Account/Fund B Grants: City of Harrodsburg, Mercer County, Kentucky - Harrodsburg Water System Improvements Phase I; Henry County Water District # 2 - Water system acquisition and

shared water tank; Electric Plant Board of the City of Vanceburg - Southern Lewis County Water Project; Cave Run Water Commission - Regional Water Treatment Plant; City of West Liberty - Water Tank Project; and Magoffin County Water District - Magoffin County Water District Water Line Extensions. Ms. Milton said the funding sources are in place, the assistance agreements have been reviewed by KIA legal counsel and signed by the Finance Cabinet, and the projects are ready for disbursement of funds.

Representative Damron asked if funding for the 2020 Account program will be able to continue without a legislative budget. Ms. Milton said the program will be able to continue because the funding for this program was authorized by the 2000 General Assembly.

Representative Damron asked if additional funds from the tobacco settlement were proposed for that program in the 2002-04 budget deliberations. Mr. Hintze said yes, at one point in the process, additional funds were added. However, the funds were not included in a version passed by either chamber in the Special Session.

Representative Damron said the tobacco settlement pool was a \$50 million bond pool. He said the General Assembly authorized the issuance of \$50 million, and pledged tobacco settlement moneys in the 2000-2002 budget to service the \$50 million debt. He asked what will the bondholders be looking to if, in the absence of a budget, the state does not authorize the payment of the bond issue from the tobacco settlement from next year's settlement moneys. Mr. Hintze said it is the Administration's view that the projects authorized by the 2000 session do not require any formal renewed action to continue the debt service payments. He said the continuation of essential core government services embraces the continuation of debt service whether it is paid from tobacco settlement moneys. However, he noted new or other additional bond issues for established programs not authorized in the 2002 session are a different matter.

Chairman Haydon said the committee's next meeting is scheduled for July 16 at 1:00 p.m. in Room 129 of the Capitol Annex. He also noted the committee's August meeting is scheduled for August 20 at Western Kentucky University.

With there being no further business, Representative Damron made a motion to adjourn the meeting. The motion was seconded by Senator Buford. The meeting adjourned at 3:00 p.m.